No. 14,450

United States Court of Appeals

For the Ninth Circuit

GEORGE W. LEWIS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF FOR THE UNITED STATES.

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No. 14,450

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GEORGE W. LEWIS,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

BRIEF FOR THE UNITED STATES.

JURISDICTION.

Appellant was indicted on January 13, 1954 in the District Court for the Northern District of California, Southern Division, for wilfully and knowingly attempting to defeat and evade a large part of the income tax due and owing by him and his wife for the calendar years 1947 and 1948 in violation of Section 145(b), Internal Revenue Code (R. 3-6).

On May 13, 1954, the jury returned a verdict finding appellant guilty on each count of the indictment (R. 16).

On June 8, 1954, the District Court committed appellant to the custody of the Attorney General for a

period of one year on each of the three counts, the sentences of imprisonment to run concurrently, and imposed a fine of $8,000 on each of the three counts, or a total fine of $24,000 (R. 18-19). Jurisdiction of the District Court was conferred by 18 U.S.C., Section 3231, and Rule 18, Federal Rules of Criminal Procedure. Notice of appeal was filed on June 8, 1954 (R. 20).

This Court has jurisdiction under 28 U.S.C., Section 1291.

QUESTIONS PRESENTED.

Whether the evidence of source of income, lack of records and beginning net worth was sufficient to support the verdict.

STATUTE INVOLVED.

Internal Revenue Code:

Sec. 145. Penalties.

* * * * * * *

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat or Evade Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and,

upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

* * * * * * *

[26 U.S.C. 145.]

STATEMENT OF FACTS.

Appellant was indicted in the United States District Court for the Northern District of California, Southern Division, in three counts charging wilful attempted tax evasion. The first count charged that he evaded his own taxes for the year 1947; the second count charged that he evaded his wife's taxes for 1947; and the third count charged that he evaded their joint taxes for 1948.[1]

To prove its case, the Government undertook to prove (1) *income* by showing that appellant had spent, invested or loaned $1,604,608.71 from 1942 to 1948 (Ex. 62); that he had available from earnings, gifts, repayment of loans and all other disclosed sources, a total of $771,615.65 in the same years (Exs. 61, 62); that allowing all adjustments for capital gains, etc., he had net taxable income greatly in excess of the amount disclosed on his tax returns and those

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[1]Set out in tabular form the indictment figures are:

	Income Reported	Correct Income	Tax Reported	Correct Tax
Count 1	$ 9,483.25	$197,300.47	$ 2,018.10	$145,761.90
Count 2	11,543.09	197,300.47	2,884.55	146,189.40
Count 3	115,153.06	308,099.51	53,113.62	199,834.82

of his wife for each year, 1942 to 1948 (R. 468-500; Ex. 63),[2] (2) *source of income* by showing that appellant had many sources of income from legitimate businesses and was also engaged in gambling activities, (3) *lack of records* by showing that he kept no records of his gambling operations, loans, investments (other than those kept in the conduct of each business by others) or other sources of income and (4) that his expenditures (falsely represented by appellant as reflecting only a prior accumulation of $1,000,000 in currency kept in suitcases) could reasonably be attributed only to unreported taxable income.

In his brief, appellant apparently concedes the accuracy of the Government's computation of the nature and amount of his expenditures and of his available funds, and contents himself with an attack on the sufficiency of the evidence to show (Ap. Br. 6):

(1) the inadequacy of the records;

(2) the net worth starting point; and

(3) the source of income.

The details of this proof, inadequately summarized in appellant's brief, show clearly that all possible requirements were fulfilled.

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[2]The amount of unreported or additional income established for each year is as follows (Ex. 63):

1942	$ 9,411.94	1946	$158,582.54
1943	1,668.59	1947	469,779.35
1944	21,632.69	1948	193,063.69
1945	39,973.52		

I. THE INADEQUACY OF THE RECORDS.

At the outset of the investigation of his tax liabilities, appellant was questioned by witness Klass, a Special Agent of the Internal Revenue Service, in the presence of appellant's attorney (R. 458). He was asked for his records and he told Klass he kept no records (R. 460, 519). The only records Klass subsequently saw were some notes for loans appellant had made to others (R. 460). Appellant refused to turn over his cancelled checks to Klass (R. 854). He also failed to supply Klass with certain information, requested by letter (Ex. 66), relating to his gambling activities (R. 857-858) and to check withdrawals (R. 929-936; Ex. 71) although the latter information was known to him (Def. Ex. M).

William Anater, a tax accountant who prepared appellant's income tax returns for 1945 to 1948 (Exs. 1, 4, 6, 18) and those of his wife for 1946 and 1947 (Exs. 2, 3, 5), testified that appellant had no record of the gambling gains reported on his 1945 returns (R. 219-222; Ex. 18) and that this information was given to him orally by appellant at the time the return was prepared (R. 220). He saw no books or records or appellant's bank statements for the year 1946, and the tax return for this year was prepared entirely from oral information given to him by appellant together with a withholding statement from the Detroit Racing Association and a partnership profit and loss statement (R. 225). He was not informed of

appellant's partnership interest in Universal Cleaners in 1946 (R. 225-226).[3]

Anater testified that appellant had no personal records in connection with the entries shown on the 1947 return (R. 228) and no records of the cost of his interest in Universal Cleaners (R. 229).

In preparation of the 1948 return, Anater saw no records of investment in Detroit Racing Association (R. 232); he did not recall any records from which the cost figures of the Alhambra Bowl were derived, but that there must have been some (R. 233), and other entries on the return were derived from statements supplied by the various business enterprises in which appellant had an interest (R. 229-236).

Appellant himself testified on direct examination to a conversation prior to indictment with an attorney of the Internal Revenue Service in December, 1953: "Well, he asked me if I could establish such a thing [the claim of $1,000,000 currency] and if I had any records or anything of that nature. And I told him that I had no records * * * (R. 727)." On cross-examination he repeatedly admitted he had no records, receipts, no retained copies of tax returns for years beginning in 1920 or records of a similar nature (R. 734-769). No books of account or similar records were produced by him at the trial.

A portion of the transcript of a proceeding in the Superior Court for the State of California, in and for

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[3]Appellant had a one-sixth interest in Universal Cleaners, but his name did not appear on the books of the partnership because of the objections of one of the partners (R. 138-139, 146-148).

the City and County of San Francisco, In the Matter of the Estate of Frank A. Girard, deceased, wherein appellant testified on a claim against the estate, was read into the record below (R. 451-455). In that proceeding appellant was asked (R. 452):

> "Q. Then there is no record of any character, receipts, cancelled checks, entries in books of account as to that $9,141.80 other than the statement here?
>
> A. I guess that is all.
>
> Q. Do you know whether it is or not?
>
> A. I never keep no records."

Appellant was again asked (R. 453):

> "Q. Are there any book entries?
>
> A. I keep no books.
>
> Q. But you keep no books of any kind?
>
> A. No."

Appellant testified that there was an amount of $4,500 owing by him to Girard. "I had made a bet on a horse and lost it and I hadn't paid it (R. 453)."[4] When asked if there were any books and records on that he replied "Not that I know of (R. 453)." He testified that all of his transactions with Girard were in cash and no receipts were taken (R. 452-454).

Appellant invested currency in various business enterprises, often such investments appearing on the books of the companies in the names of others. He furnished funds for investment in Universal Cleaners

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[4]On cross-examination in the case at bar, appellant said that he testified falsely in the probate proceedings as to what the $4,500 was for (R. 852).

(R. 133-143) but did not appear as one of the partners on the books (R. 138-139). He invested $90,000 in 1946 in Laird Medical Building, Inc., the total capital of the corporation, but only 216 shares of stock were issued in appellant's name, the remaining shares being in the names of Messrs. Braden, Girard, Laird, who had 216 shares a piece, and 36 shares to Anater (R. 172-173, 252, 418-419). He had custody of the stock certificates in the names of Anater and Laird, and they were ultimately transferred to his name without consideration (R. 252-253, 419-420). A loan of $5,000 by appellant to the corporation was made in 1946 in Laird's name, and a $20,000 loan was made in 1947 in the name of Girard (R. 256-261, 421; Exs. 24a, b; 62). An investment in 1946 in Holland's Frozen Foods was in Anater's name (R. 245).

II. THE NET WORTH STARTING POINT.

In the absence of records, the necessary theory of the prosecution was that the appellant had made large cash expenditures during the years 1947 and 1948 which exceeded funds available to him as reported on his income tax returns and from non-taxable sources, and that such expenditures were derived from current income. In order to preclude the hypothesis that such expenditures were made from prior accumulated funds, evidence of his financial status at a fixed time was produced. The time chosen was December 31, 1941.

One facet of this evidence consisted in part of tax transfer vouchers (Exs. 10-12j, inclusive), setting up a tax liability of $4,096.09 against appellant as transferee of the Arcadia Corporation, a Washington dog race track, for the year 1933. The liability was originally transferred to the Office of the Collector of Internal Revenue for the First Collection District of California on July 13, 1936 (R. 35) and thereafter the account was transferred to various collection districts in Ohio, Michigan, and Florida (R. 30-43; Exs. 11, 12). On January 16, 1940 the liability had increased to $4,414.77 by reason of accrued interest, and it was transferred on that date to Jacksonville, Florida (R. 43) together with a $500 government check which was a refund check to appellant of an amount he had submitted with an offer in compromise of the account in Michigan (R. 49-51). No assets of appellant were found in the various collection districts from which the liability could be collected (R. 47; Exs. 11a, b, c).

On March 25, 1940 appellant offered $500 to the Collector of Internal Revenue at Jacksonville, Florida, in full settlement of the liability of $4,414.77, stating in the offer signed by him under oath that the corporation owned no assets and "my net worth nil (R. 58-59; Ex. 13)." On January 15, 1941 appellant filed a new offer increasing the amount in settlement to $1,000 (R. 61, Ex. 14a). A further amended offer was submitted on April 15, 1941, signed by appellant under oath, in which the offer was increased to $1,500, to be paid $750 down and the balance of $750 in monthly

installments of $150 beginning June 15, 1941 (R. 63-66, Ex. 14c). The reasons set forth in the offer as grounds for acceptance were: "Corporation has no assets and my inability to pay more than the amount tendered (R. 65, Ex. 14c)."

On October 8, 1941 appellant filed an amended offer in compromise, signed and sworn to under oath, offering $1,500 in settlement of the tax liability of Arcadia Corporation, the amount to be paid from $750 on deposit and the balance of $750 within 10 days after acceptance (R. 70-72; Ex. 14f). In the offer he stated he was unable to pay more than the amount offered (Ex. 14f). This final offer was accepted on December 31, 1941 (Exs. 14g, 14h) and was paid on February 11, 1942 (R. 77).

As further evidence of appellant's financial condition, there was introduced into evidence a financial statement signed by him and sworn to as being true and complete in every respect as of November 3, 1941, the date of its preparation and signing (R. 342-349, 820-829; Ex. 58). In this statement appellant listed his assets as follows:

Cash	$5,100
Notes Receivable	None
Accounts Receivable	None
Automobile	1,300
Stocks and Bonds	None
Real Estate	None

Liabilities were listed as "Owe $750 on offer in compromise for taxes assessed against me as transferee of Arcadia Corporation." The statement called for gross

income for the past three calendar years, which was given as: "1939, $4,600; 1940, $5,100; 1941, $9,700 (R. 347, Ex. 58)."

Appellant made a statement on October 11 and 12, 1951 to Agents Klass and Alliguie of the Internal Revenue Service, while represented by counsel, and subsequently signed the statement under oath (R. 458-459). At that time he stated he had received Christmas gifts of $2,500 each from Mr. Lehr and Mr. Strong in each year from 1936 to 1946, and had received no other gifts (R. 461); that he did not know what assets he had at the end of 1941 or of any year from 1941 to 1948 (R. 461-462, 809); that he had received no inheritances (R. 459); no benefits from trust funds (R. 460); and that he did not know who owed him money nor how much (R. 460).

During the years 1942 to 1948 appellant dealt largely in currency, with the amount of his expenditures increasing regularly each year and amounting to $525,230.25 for the year 1947 and $577,466.87 for 1948 as detailed in Exhibit 62. It would require a complete summary of all the testimony to set forth the extent of appellant's cash (currency) dealings, but it is a fair statement that the bulk of his loans and investments were made with currency and no records were kept by him of these amounts (R. 468-492).

Further evidence of appellant's lack of cash on hand was demonstrated by a loan he made from the Bank of Ohio for $30,900 on May 15, 1944, which was paid down by installments to $19,900 on May 15, 1945

and renewed on maturity in the amount of the balance and paid off by installments ending May 13, 1946 (R. 127-130; Exs. 25, 26, 27). In 1944 he turned in a life insurance policy for its cash surrender value of $2,247.45 (R. 833; Exs. 53, 61).

In June, 1947, appellant was interviewed by John J. Madden, a Treasury agent, about his 1945 tax return (R. 898). During the course of that interview he was asked how much money he had, and he told Madden that at the time of the meeting (June, 1947) he had several thousand dollars on his person and at least $50,000 in his safe at his home (R. 900, 908).

Although appellant testified he had paid substantial amounts of income tax in the years 1920 to 1930, he had no record of his returns or payments (R. 620-630, 731-754). Records of the Internal Revenue Service for all persons with the same name as appellant who filed returns at San Francisco, California, showed only nominal tax payments, when any, of not more than $75 in any one of those years (R. 918-923; Exs. 68, 69a-1), and no record for 1930 or 1931 (R. 923). From 1932 to 1935 Internal Revenue Service records disclosed total tax paid by appellant and his wife jointly of $862.16 (R. 923-926; Ex. 70).

Records of other tax collection districts wherein appellant had resided during 1920 to 1941 were offered in evidence by the Government and excluded on objection of appellant (R. 936-941).

The starting point for determination of appellant's net worth, and of moneys received and expended by

him, was December 31, 1941 (R. 465; Exs. 61, 62). He was credited on that date with $5,000 he said he had received as gifts for Christmas, 1941, and the $5,100 cash shown by his written and sworn statement of assets and liabilities filed with the Internal Revenue Service on November 3, 1941 (R. 343-349, 469; Ex. 58). In 1942 he spent $9,425.53 more than his reported earnings, gifts and other non-taxable funds available (R. 471; Exs. 61, 62). In 1943 he spent $8,397.40 less than funds available from all known sources, and this amount was credited as cash on hand at the beginning of 1944 (R. 471-472; Exs. 61, 62, 63). In 1944 he spent $20,877.51 more than reported income and non-taxable funds available (including cash on hand carried over from the prior year) (R. 473-474; Exs. 61, 62, 63). In 1945 he spent $24,099.11 more than his reported income and non-taxable receipts (R. 476, 477; Exs. 61, 62). In 1946 he spent $159,633.93 more (R. 480; Exs. 61, 62, 63). In 1947 he spent $468,095.66 more (R. 486), and in 1948 he spent $159,258.72 more than available according to his tax returns and non-taxable receipts (R. 491; Exs. 61, 62).

III. THE SOURCE OF THE INCOME.

Appellant has been associated with horse racing tracks all of his adult life, both as an employee and as a "bookmaker" handling bets and "come-back" money (R. 614-615, 730-863). He worked in many places but from 1924 to and including 1948 he used a

cigar store and club located at 84 Ellis Street, San Francisco, California, as his office and mailing address, and placed that address on some of his tax returns (R. 76, 266-267, 372-373, 454-455, 711, 753, 803, 896). This establishment was described by Earl Beasley as a place where he had seen bets taken on horses (R. 374-375). During the fall of 1947 or the spring of 1948 appellant admitted to William Gaskill that he owned the cigar store on Ellis Street (R. 361). Appellant shared the safe in the club with Mr. Girard for 15 years (R. 709, 804). He also admitted personal wagering on horse races both on and off the tracks (R. 453, 799-803, 848). In his testimony on a claim against the estate of Frank A. Girard, appellant testified that he owed Girard $4,500 because "I had made a bet on a horse and lost it and hadn't paid it. (R. 453)."

Gaskill testified to a conversation in his presence between appellant and Girard in the fall of 1947 or spring of 1948 when appellant told Girard to make a $15,000 bet on a horse the next day (R. 358-360).

Beasley testified that he had a horse named "The Man" running at Tanforan in 1947 or 1948, he was not sure of the date; that he told appellant he thought the horse would win; that afterwards appellant told him he had lost $125,000 on the horse; and that Beasley accompanied him from 84 Ellis Street to a bank where appellant took money out of a safety deposit box to pay the bet (R. 372-374). Before going into the bank appellant took a book out of his pocket and said "Don't call me by my name when you go in there; I got several boxes; don't call me by my name

(R. 373)." Appellant had a safety deposit box from 1944 to 1948 in the name of his nephew, who was seven years old in 1945 (R. 780-781), and had another safety deposit box in the name of George Williams which he opened in 1944 (R. 782) or 1945 (R. 807). Appellant admitted making a "small bet" of $1,000 on "The Man" when he ran at Tanforan on December 3, 1948 (R. 703-704; Def. Ex. L).

A deposition of John J. Gedert, taken on motion of the appellant, is among the exhibits transmitted to this Court. Gedert therein states that appellant received a salary of $100,000 in 1948 and a bonus of around $100,000 in connection with his employment by the Detroit Racing Association (Deposition, page 39). No part of the bonus was reported in the 1948 tax return of appellant and his wife (Ex. 6).

Appellant had a partnership interest in Laurel Pottery Manufacturing Company, the partnership return of which company showed his distributive share of partnership income for the fiscal year ending March 31, 1948 to be $43,198.44 (R. 238-239; Ex. 9). None of this amount was reported in his 1948 return (R. 239; Ex. 6).

IV. THE DEFENSE.

Appellant has not attacked the accuracy of the Government's computations in his brief, and during cross-examination he conceded that the figures of expenditures and receipts in Exhibits 61 and 62 were substantially correct (R. 858-861). The defense was

that appellant had earned $1,000,000 from bookmaking activities by 1928 or 1930 (R. 631, 771); that he accumulated nothing further and still had the million dollars in 1941 (R. 654, 772). On cross-examination he first testified he still had the million dollars at the end of 1948 (R. 772). When it became apparent to him that he had trapped himself by this answer, he claimed to have misunderstood the questions to mean all his assets rather than currency alone (R. 773).

Appellant was then taken back over the same ground and testified that all of his assets at the end of 1941 were in cash of approximately $1,000,000; that he invested $100,000 in 1942; and still had $900,000 cash on hand at the end of 1946, $75,000 in cash at the end of 1947[5] and that he could not tell how much he had at the end of 1948 (R. 774-777).

Appellant's wife testified that she had first seen currency in a suitcase belonging to appellant in 1928, about three years after their marriage (R. 562-565, 570-575); that she had never counted the money and did not know how much was in the various suitcases used for storage of money at any time (R. 565, 574); that the suitcases were carried around in the car from place to place until 1947 when a permanent home was purchased (R. 567, 573-576); and that she imagined he still had money in a suitcase in 1949 (R.

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[5]Appellant spent $525,230.25 in 1947, while having only $57,134.59 available from reported taxable income and non-taxable receipts. Even assuming he spent $150,000 from his claimed cash hoard, this does not account for the additional expenditures of $318,095.66 which he admittedly made in 1947 (Exs. 61, 62, 63).

576). Other defense witnesses testified generally to indefinite amounts of money allegedly in appellant's possession at various times but either had not seen the money or had not counted it or did not know if it belonged to appellant (R. 436-441, 589-602, 609).

SUMMARY OF ARGUMENT.

Reduced to its simplest terms, appellant's main argument is that the jury's verdict was not warranted by the evidence admitted against him. The Government failed, he argues, to establish by competent evidence that his records were inadequate to warrant use of an indirect method of proof of income; to show the source of his income; or to show his beginning and ending net worth. The argument is refuted by the record.

Without citing authority or dwelling upon the issue in his argument, appellant merely asserts that proof of inadequacy of records is a condition precedent to use of the method of indirect proof of income here employed. Assuming, *arguendo,* that proof of lack of records is essential, this requirement has been amply fulfilled.

The evidence clearly shows that appellant kept no records, and he produced none during the investigation (except fragmentary notes for money loaned) or during the trial. He refused to make cancelled checks available to the Treasury agents. Except for records of businesses in which appellant had an interest, which were kept by others, his accountant saw no records when the tax returns were prepared. Ap-

pellant repeatedly admitted during the trial and prior thereto that he kept no records.

The law is also clear that proof of the exact amount or precise source of income is not required. There was evidence that appellant was engaged in personal gambling on horse races and also owned an establishment where such bets were taken. One of his own witnesses testified by deposition to a $100,000 bonus paid appellant in 1948 which was not reported. The evidence also showed that he had income from partnerships which was not reported. The jury was entitled to infer that his income came from one or all of the various sources, both legitimate and illegitimate, proved during the trial.

By his own prior sworn admission, appellant's net worth was $6,400 in November, 1941, including $5,100 in cash. In October, 1941, he offered to settle a long outstanding tax liability of $4,414.77 for $1,500 with the sworn statement that he was unable to pay more. The record of his tax returns for years going back to 1920 showed no large earnings from which an accumulation of funds could have been made. He borrowed $30,900 in 1944 and paid it in installments over a two year period. In 1944 he also cashed in a life insurance policy. In 1947 he claimed to have only $50,000 in cash at home and a few thousand dollars on his person. He was given credit for all gifts he claimed to have received, and admitted he had no inheritances or trust funds.

Thus, there was a firm starting point for the computations showing huge expenditures in excess of

available declared resources for each year from 1942 to 1948. The gradual increase of the expenditures fortified the conclusion that they came from large unreported earnings. This evidence convincingly established the appellant's cash on hand and defeated his single contention—that the expenditures reflected only a hoard of idle cash accumulated over a decade before. The jury's verdict was plainly proper.

ARGUMENT.

A jury under instructions which were without dispute correct in defining the quantum of proof necessary for conviction, found appellant guilty. In this Court, appellant undertakes the difficult burden of urging as his primary ground for reversal that the evidence was in various respects insufficient to support the verdict. Although he relies upon seven specifications of error, he concedes that they all amount to an attack on the sufficiency of the evidence (Ap. Br. p. 11).[6]

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[6]It is a well established principle that this Court, in determining whether the evidence is sufficient to sustain the verdict, will view the record in the light most favorable to the Government and affirm if the evidence, so viewed, was sufficient to justify the jury in finding, beyond a reasonable doubt, that there has been a willful attempt to evade taxes.

Papadakis v. United States (C.A. 9, 1953), 208 F.2d 945;
Gendelman v. United States (C.A. 9, 1951), 191 F.2d 993, 995, cert. den. 342 U.S. 909;
McFee v. United States (C.A. 9, 1953), 206 F.2d 872, 874, cert. den. 347 U.S. 927, order denying cert. vacated 347 U.S. 1007;
Norwitt v. United States (C.A. 9, 1952), 195 F.2d 127, cert. den. 344 U.S. 817.

I. THE NET WORTH STARTING POINT WAS FIRMLY ESTABLISHED.

The Government's proof that appellant had wilfully attempted to evade substantial income taxes showed that (except for 1943) in each of the years from 1942 to 1948, inclusive, appellant spent far in excess of the sum of the income reported on his tax returns and funds available from all other sources. Although described by the witness Klass as "the net worth method or an outgrowth of the net worth method called the source and application of funds method (R. 465)", the system employed is more commonly known as the net worth-expenditures method (R. 542). Such methods have been universally recognized by Federal Appellate Courts as valid means of proving wilful attempts to evade income taxes.

United States v. Johnson (1943), 319 U.S. 503, 517;

Smith v. United States (C.A. 1, 1954), 210 F.2d 496, certiorari granted, 347 U.S. 1010;

United States v. Norris (C.A. 2, 1953), 205 F.2d 828;

United States v. Vassallo (C.A. 3, 1950), 181 F.2d 1006;

Bell v. United States (C.A. 4, 1950), 185 F.2d 302, certiorari denied, 340 U.S. 930;

Sasser v. United States (C.A. 5, 1953), 208 F.2d 535;

Gariepy v. United States (C.A. 6, 1951), 189 F.2d 459;

United States v. Chapman (C.A. 7, 1948), 168 F.2d 997, certiorari denied, 335 U.S. 853;

Mitchell v. United States (C.A. 8, 1954), 208 F.2d 854, certiorari denied, 347 U.S. 1012; *Barcott v. United States* (C.A. 9, 1948), 169 F.2d 929, certiorari denied, 336 U.S. 912; *Holland v. United States* (C.A. 10, 1954), 209 F.2d 516, certiorari granted, 347 U.S. 1008.

Additionally, this Court has recently approved net worth and expenditures methods of proof in *McFee v. United States* (1953), 206 F.2d 872, certiorari denied 347 U.S. 927, order denying certiorari vacated 347 U.S. 1007; *Remmer v. United States* (1953), 205 F. 2d 277, judgment vacated on other grounds 347 U.S. 227; *Davena v. United States* (1952), 198 F.2d 230, certiorari denied 344 U.S. 878; *Calderon v. United States* (1953), 207 F.2d 377, certiorari granted 347 U.S. 1008; *Goldbaum v. United States* (1953), 204 F.2d 74, certiorari denied 346 U.S. 831, order denying certiorari vacated 347 U.S. 1007; *Bateman v. United States* (1954), 212 F.2d 61; *Gendelman v. United States* (1951), 191 F.2d 993, certiorari denied 342 U.S. 909; *Chan Shing Ho v. United States* (1951), 186 F.2d 574; *Papadakis v. United States* (1953), 208 F.2d 945.[7]

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[7]On June 7, 1954 the Supreme Court granted certiorari in *United States v. Calderon,* supra, and vacated its earlier orders denying certiorari in *McFee v. United States,* supra, and *Goldbaum v. United States,* supra, and restored them to the docket. It also granted certiorari in *Friedberg v. United States,* 347 U.S. 1006, reported below 207 F.2d 277 (C.A. 6); *Holland v. United States,* supra, and *Smith v. United States,* supra. The order denying certiorari in *Banks v. United States* (C.A. 8), 204 F.2d 666, certiorari denied 346 U.S. 857, was likewise vacated and the case restored to the docket 347 U.S. 1007. Each of the cases in which certiorari was granted involves a conviction for evasion of income taxes obtained by use of the net worth-expenditures method.

In *McFee v. United States,* supra, this Court recognized that the expenditures and net worth methods are "merely accounting variations of the same basic method, the expenditures theory being an outgrowth of the net worth method." The underlying theory of each method is that if expenditures or accumulations of assets, or both combined, exceed reported income for the period, and the expenditures or net worth increases are not attributable to non-taxable sources such as gifts, devises, loans or a prior accumulation of funds, the conclusion may be drawn that either the excess of expenditures over receipts or the net worth increases, or a combination of the two, is a measure of income.

It is fundamental that in order to make a *prima facie* case the Government must establish the taxpayer's net worth at the beginning of the period in question with a reasonable degree of certainty; otherwise the increase might be more apparent than real. *Sasser v. United States,* supra, page 537; *Bell v. United States,* supra, page 308; *Brodella v. United States* (C.A. 6, 1950), 184 F.2d 823, 824; *Calderon v. United States,* supra. Proof of a taxpayer's visible assets and his liabilities at the beginning of the prosecution years may not establish firmly the starting point net worth, because the taxpayer may have had other assets, particularly currency, hidden from view. *Bryan v. United States* (C.A. 5, 1949), 175 F.2d 223,

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Although the opinions are not available at this writing, it is understood that the Supreme Court on December 6, 1954 upheld the Government's contentions in each of the cases in which certiorari was granted.

affirmed, 338 U.S. 552; *United States v. Fenwick* (C.A. 7, 1949), 177 F.2d 488. There must be solid evidence to bolster the conclusion that the taxpayer has been given credit for all the assets he owned at the beginning point. Such evidence usually consists of an admission from the taxpayer, prior actions inconsistent with wealth, or the results of an investigation into his financial history prior to the prosecution years. If such evidence is not available and presented, the Government fails to sustain its burden of proof because it has not foreclosed the possibility that what appear on the surface to be net worth increases are in fact merely the result of a change in the form of previously acquired assets. *Bryan v. United States,* supra.

But where the Government does present such evidence, its burden is simply to make a *prima facie* case. Its evidence must be sufficiently substantial to warrant a jury in concluding that the defendant did not in fact have concealed assets not revealed in the starting point computation. The Government is not required to refute all conceivable speculation as to the source of a taxpayer's funds or to prove the precise amount of his undeposited cash on hand at the starting point. *Gariepy v. United States,* supra, page 463; *Schuermann v. United States* (C.A. 8, 1949), 174 F.2d 397, 399, certiorari denied, 338 U.S. 831; *Bell v. United States,* supra, page 308.

The extent of appellant's net worth was shown by his own statement made *ante litem motam* on November 3, 1941, at which time he had $5,100 in currency

and an automobile valued at $1,300 (R. 349; Ex. 58). The net worth starting point at December 31, 1941 included this cash on hand and allowed an additional $5,000 which appellant claimed to have received as Christmas gifts in 1941 (Ex. 62).

Further evidence of a lack of ready cash prior to 1941 consisted of a series of offers in compromise of a tax liability of slightly over $4,000 outstanding from 1933 to 1941 when a $1,500 offer was accepted in full settlement (R. 55-93). In the various attempts to compromise this liability, appellant repeatedly referred to his inability to pay more and asserted that his net worth was nil (Exs. 13, 14 a-j). The record of his income tax returns for two decades before revealed only nominal amounts of tax and an income grossly inadequate to corroborate the alleged earnings from which the claimed $1,000,000 in currency was put aside (R. 918-923).

Thus, there was a firm starting point on December 31, 1941 which amply foreclosed the hypothesis of prior accumulated funds. Appellant appears to contend, however, that the starting point selected should have been December 31, 1946 (App. Br. 15-18). Any prior net worth starting point is satisfactory, for it serves only as a firm foundation so that the increment in net worth and non-deductible expenditures can be compared with the income actually reported. To establish a solid basis for the computations of his later expenditures, no matter what date is selected, and building upon that foundation year by year to the first year in the indictment, is to fix the taxpayer's

net worth at each point of the case. The determination of appellant's net worth at the end of each year from 1942 to 1948 is a mere mathematical calculation.

As shown by Exhibit 62, it was a physical impossibility for him to have accumulated funds from 1942 to the end of 1946, for he was spending in those years a total of $205,638.68 more than he reported as income and had available from non-income sources. The jury was entitled to infer from this circumstance, and his lack of funds prior to 1941, that the further expenditures in 1947 and 1948 were from current earnings. Moreover, appellant does not contend that he earned the excess funds from 1942 to 1946, but has consistently alleged that his returns for those years were correct (R. 463-464, 730).

The practice of reaching into the taxpayer's past to establish his financial condition for years prior to the first indictment year has been repeatedly approved by the Appellate Courts. In *McFee v. United States,* supra, the inquiry began with the year 1935, although the first indictment year was 1945. In *Gariepy v. United States,* supra, the inquiry began with 1938, and the first indictment year was 1944. The prosecution years in *United States v. Skidmore* (C.A. 7, 1941), 123 F.2d 604, were 1931 to 1938. Proof of cash status reached back to 1919. In *United States v. Johnson,* 319 U.S. 503, the indictment years were 1937 to 1939. Johnson's cash resources were shown at the beginning of 1932, to which were added his receipts and from which were subtracted his ex-

penditures to arrive at his cash balance at the beginning of 1937. This is the identical formula employed by the prosecution in this case. See also *United States v. Potson* (C.A. 7, 1948), 171 F.2d 495; *Barcott v. United States,* supra.

Appellant relies on *United States v. Fenwick,* supra, and *Bryan v. United States,* supra. This Court has had occasion recently to consider these cases in *Remmer v. United States*, supra, and *Davena v. United States*, supra, with the following observation in the *Remmer* case:

> "This Court, in Davena v. United States, questioned the 'vitality of the Fenwick case, and the majority opinion in the Bryan case was accompanied by a strong dissent. Although these decisions may well have been appropriate because of the particular facts there involved, we believe the general language of the opinion too narrowly limited the function of the jury as the triers of fact.' "

Moreover, the Court of Appeals for the Seventh Circuit in *United States v. Yeoman-Henderson* (1952), 193 F.2d 867, 869 restricted its general statements in *Fenwick* to the facts of that case and the Court of Appeals for the Fifth Circuit in *Pollock v. United States* (1953), 202 F.2d 281, 284 encountered no difficulty in distinguishing *Bryan* on the same basis.

Of course, the expenditures in excess of reported income for the earlier years was admissible not only to connect the starting point cash or asset position of appellant to the first indictment year, 1947, but

also as a course of fraudulent conduct to establish fraudulent intent as an element of the crime charged. *Mitchell v. United States* (C.A. 9, 1954), 213 F.2d 951, 956, and cases cited therein.

Nor is there any merit in appellant's contention that the Government failed to prove his ending net worth. Given a firmly established starting point, and uncontested subsequent expenditures in excess of funds available, it is obvious that the ending net worth is merely the sum of the various accumulations. If, perchance, appellant had additional funds on hand at the end of 1948, or undiscovered assets, the result of the failure to prove such items is clearly favorable to him. He could not have had less than shown by the Government, and to the extent that he had more, his unreported income was even greater than the amount shown. And in any event, the Government need not prove the amount of his understatement to a mathematical certainty, but need only show that he owed more tax than he paid. The amount of the tax is not the gist of the offense and, as stated in *Cooper v. United States* (C.A. 8, 1925), 9 F.2d 216, 224 "It was necessary only that it should appear that *some* amount was due, and that the returns were knowingly false and fraudulent in that respect." (Italics supplied.) *United States v. Schenck* (C.A. 2d 1942), 126 F.2d 702.

II. AMPLE SOURCE OF FUNDS WAS SHOWN.

Assuming, *arguendo*, that evidence of a source of income is essential to the proof of a tax evasion prosecution, that requirement has been amply met in this case. There was evidence, denied by appellant, that he was the owner of an establishment where bets were taken on horse races (R. 361, 374-375). He frequented the establishment weekly (R. 850-852); shared the safe for years with Mr. Girard (R. 804); and he testified in the proceedings on a claim against Girard's estate that he bet with Girard (R. 453, 852). He bet $15,000 with Girard on a horse race in 1947 or 1948 (R. 358-360). He did personal betting on horses both on and off the track (R. 800). He admitted a small bet of $1,000 on "The Man", a horse which raced in 1948, but denied having lost $125,000 on the race (R. 800). He had bet on other horses owned by Beasley and had won (R. 802). Except for the year 1945, no gambling gains of any nature were reported on his tax returns.

His own witness, Gedert, testified by deposition that the Detroit Racing Association paid appellant a $100,000 bonus in 1948 which was not reported. The records of the Detroit Racing Association were destroyed (R. 528).

Appellant was also a partner or investor in various business enterprises (Ex. 62). He failed to report income from Universal Cleaners in 1947 (R. 546). In 1948 he failed to report income from Laurel Potteries Manufacturing Company of $43,198.44, which amount was reported instead by the other partners

R. 238-244, 549-551). Interest of $625.36 on a loan made in Laird Medical Building, Inc. in the name of Frank Girard (R. 551-552), and $6,000 premium on a loan to Alhambra Bowl (R. 553-554) were not reported in 1948.

There was ample evidence of a possible source or sources of income from which appellant's expenditures in excess of his declared available resources could have been made. As stated by this Court in *McFee v. United States* (C.A. 9, 1953), 206 F.2d 872, 874, cert. den. 347 U.S. 927, order denying cert. vacated 347 U.S. 1007, "The law is clear that proof of the exact amount or precise source of unreported income is not required." *Jelaza v. United States* (C.A. 4, 1950), 179 F.2d 202; *Gariepy v. United States* (C.A. 6, 1951), 189 F.2d 459; accord: *United States v. Chapman* (C.A. 7, 1948), 168 F.2d 997, certiorari denied, 335 U.S. 853; *United States v. Johnson* (1943), 319 U.S. 503, 517; *Goe v. Commissioner,* 10 TCM 307, 313-314, aff'd 198 F.2d 851.

III. THE RECORDS WERE NON-EXISTENT.

Appellant asserts, but does not argue, that the Government was required to establish the inadequacy of his records before introducing evidence of the net worth starting point (App. Br. pp. 13-14). He cites no authority for this proposition. However, this Court in *Remmer v. United States* (1953), 205 F.2d 277, judgment vacated on other grounds 347 U.S. 227, stated "The net worth method of computing income

may be used only where a taxpayer does not keep books or such books are inadequate in that they do not clearly reflect income. See 26 U.S.C., Section 41."[8] This Court appears to have rejected the same argument in the earlier case of *Chan Shing Ho v. United States* (1951), 186 F.2d 574.

While it is unnecessary in our opinion to reach the question—since, as has been shown (Statement of Facts, Part I, pages 5-8), appellant had no books—in view of the apparent conflict between the *Remmer* and *Chan Shing Ho* cases, we respectfully submit hereinafter our views that Section 41 does not impose a limitation on the use of net worth-expenditures methods of proof of criminal tax evasion prosecutions.

The net worth method is not a method of accounting; its purpose in a criminal case is not to recompute the taxpayer's actual income, in order to determine his exact civil liability in dollars and cents. It is a method of proving, by relevant circumstantial evidence having probative value, that there is a substantial understatement in the taxpayer's reported income

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[8]Internal Revenue Code, Section 41 (26 U.S.C. Section 41):

> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

and tax.[9] Even though a taxpayer's method of accounting appears, on the face of his books, to reflect clearly his income, the Government is not precluded from showing that some items of income have not been reported. The net worth method is not a substitute for the cash, accrual, or installment method of accounting. It is simply a means for proving that a taxpayer, whatever his method for keeping books, has failed to show items of taxable income.

Section 41 deals with whether a taxpayer, in view of the character of his business and the nature of his activities and transactions, should be on one or the other basis of accounting or on a calendar or fiscal year basis. Treasury Regulations 118, Section 39.41-2. That is a problem of accounting, the kind of problem involved in cases like *Lucas v. American Code Co.,* 280 U.S. 45; *Dixie Pine Co. v. Commissioner,* 320 U.S. 516, 518-519; *Security Mills Co. v. Commissioner,* 321 U.S. 281. But where a taxpayer either keeps no books, or books which are incomplete, inaccurate, or otherwise unsatisfactory, the Commissioner is authorized to use such means for reconstructing his income (including the net worth method) as may establish the correct amount. Treasury Regulations, 118, Section 39.41-1; *Halle v. Commissioner* (C.A. 2), 175 F.2d 500, 502-503; *Harris v. Commis-*

[9] "While the government had the burden of proof, it was not required to make a perfect case or to prove the defendant guilty to a mathematical certainty. The government did not have to establish the exact amount of unreported income of the defendant. *United States v. Johnson,* 319 U.S. 503, 517." *Schuermann v. United States* (C.A. 8, 1949), 174 F.2d 397, 399, certiorari denied, 338 U.S. 831.

sioner (C.A. 4), 174 F.2d 70, 72-73; *Cohen v. Commissioner* (C.A. 10), 176 F.2d 394, 397; *Richards v. Commissioner* (C.A. 5), 111 F.2d 374, 375; *Bishoff v. Commissioner* (C.A. 3), 27 F.2d 91, 93. The computation of income by examining increases in net worth involves no change of method of accounting from that employed by taxpayer. It is not his method or basis of accounting, but the income not accounted for and reported which forms the basis of this prosecution.

A solidly based net worth computation may provide sufficient evidence in itself that the taxpayer's method of keeping his books does not clearly reflect his income. For if the Government establishes both the totality of the taxpayer's assets at the starting point, and excessive expenditures or increases in his net worth, by evidence which, if believed, would leave no room for a reasonable doubt, the only reasonable inference must be that his books do not properly reflect all of his transactions. *Doyle v. Mitchell Bros. Co.,* 247 U.S. 179, 189; *Del Marcelle v. Kuhl,* 80 F. Supp. 616, 618 (E.D. Wis.).

Section 41 cannot be construed, therefore, to require the Government to prove the inadequacy of a defendant's *method* of accounting before it may proceed to prove its case by circumstantial evidence. There is no such rule in criminal law,[10] and neither the lan-

[10]Truth may be established just as solidly by circumstantial evidence as by direct. In each case the determination depends, not upon the type of the evidence, but by its convincing quality.

guage of Section 41 nor anything that we have been able to find in its legislative history indicates a Congressional intent to make it applicable to criminal cases. It should be noted that the statute refers to computations made by the Commissioner. But the Commissioner is not a party to a criminal case. Civil tax cases are disputes between the taxpayer and the Commissioner, the question is the *exact* amount of tax owed, and the burden of proof rests upon the taxpayer to show that the Commissioner's computation is erroneous. In criminal cases, however, the issue is whether the taxpayer fraudulently attempted to evade *some* of his income taxes, and the burden of proof is on the Government. The Government must prove, by competent evidence and beyond a reasonable doubt, that the defendant has violated Section 145(b) of the Internal Revenue Code, supra, which punishes "any person who willfully attempts in any manner to evade or defeat" tax liability.

The breadth of this provision has frequently been noted by the Supreme Court. *Spies v. United States,* 317 U.S. 492, 499; *United States v. Johnson* (1943), 319 U.S. 503, 517; *United States v. Beacon Brass Co.,* 344 U.S. 43, 45-46. The choice of methods of proof rests with the Government; and Section 41 has reference, not to methods of proof in criminal cases, but to the various recognized basic "methods of account-

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United States v. Becker (C.A. 2), 62 F.2d 1007; *McCoy v. United States* (C.A. 9), 169 F.2d 776, 784-786, certiorari denied, 335 U.S. 898; I and IX *Wigmore, Evidence,* Secs. 25-26, 2497; II *Wharton, Criminal Evidence* (11th ed. 1935), Sec. 926.

ing", e.g. cash, accrual, or installment, used in com puting civil tax liability. See *Healy v. Commissioner* 345 U.S. 278, 281. Section 41 simply gives the Commis sioner authority to change the taxpayer's metho of accounting, where it does not clearly reflect the in come, from one basis to another. It does not dea with a situation like this where the taxpayer ha wilfully concealed items of taxable income.

If appellant's objection goes to the *order* of proof it is equally without merit for it has long been estab lished that the order in which evidence is received i within the sound discretion of the trial Court, an the ultimate collocation of all the evidence for th jury. *Chadwick v. United States* (C.A. 6, 1905), 14 F. 225, 241; *Hoeppel v. United States* (C.A. D.C 1936), 85 F. 2d 237, 242. The Government is nc required to refute all possible speculation as to th sources of funds from which the expenditures migh have been made. *McFee v. United States* (C.A. 9 1953), 206 F.2d 872, 874, cert. den. 347 U.S. 92 order denying cert. vacated 347 U.S. 1007; *Gariep v. United States* (C.A. 6, 1951), 189 F.2d 459, and i went far beyond its reasonable obligation in tha respect.

CONCLUSION.

Appellant was properly convicted on evidenc legally admissible and amply sufficient to suppo

the verdict. The judgment of conviction should be affirmed.

Dated, San Francisco, California,
December 10, 1954.

Respectfully submitted,

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